Service Date: December 5, 1997

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF MONTANA POWER COMPANY, Revenue Requirements, Gas Costs, Allocated Cost of Service and Rate Design for Natural Gas Service, Restructuring, and Consolidation of Related Cases and Issues.	)))))	UTILITY DIVISION DOCKET NO. D96.2.22 ORDER NO. 5898e

ORDER ON RECONSIDERATION

I. INTRODUCTION

1. On October 31, 1997, the Public Service Commission (PSC or Commission) issued a Final Order, Order No. 5898d, in the above-entitled matter, approving a restructuring of Montana Power Co.'s (MPC) natural gas utility and allowing for competition and customer choice in gas supply in MPC's gas service area. On November 10, 1997, Enron Capital and Trade Resources Co. (Enron), an active party throughout proceedings in the matter, moved for reconsideration and clarification of Order No. 5898d in accordance with the PSC procedural rule ARM 38.2.4806. On November 20, 1997, the PSC waived ARM 38.2.4806(5)'s 10-day requirement (waivable) for ruling on motions for reconsideration, including for the purpose of allowing additional time to consider Enron’s motion.

2. In its motion Enron suggests that a statement made in the PSC's order requires clarification. In its motion Enron also suggests that several conclusions reached in that order are not supportable in fact or law. The PSC, having fully considered Enron's motion for clarification and reconsideration and Enron's arguments in support, determines that Enron's requests should be denied.

II. REQUEST FOR CLARIFICATION

3. In its motion for clarification Enron questions the meaning of a PSC statement made at several points in Order No. 5898d. The statement, which is included at paragraphs numbered 18, 23, 28, 64, and 92, of the order, all being general provisions pertaining to PSC approval of stipulations filed in the proceeding, provides that the PSC's approval of each

stipulation is "subject to qualifications and conditions as may be established by this Final Order." Enron questions this statement as it applies in paragraph 64 (PSC approval of Stipulation #3 on rate moratorium, allocated cost of service and rate design, competitive transition charges, supply contracts, and universal system benefits) and paragraph 92 (PSC approval of the GTC-1 Stipulation on transportation general terms and conditions and standards of conduct). Enron indicates that it is unable to find any "qualifications and conditions" which pertain to the stipulations to which these two paragraphs apply.

4. The PSC determines that the statement does not require clarification. In plain meaning the statement neither states nor implies that there are qualifications or conditions. At paragraphs 64 and 92 the statement is merely included as a safeguard. In the event that a problem might arise in interpretation or application of a provision within the approved stipulations, including in regard to how it might interrelate with provisions in other stipulations or with provisions of the order itself. The statement essentially provides that qualifications and conditions in the order, if any, will control in the event of conflict. In regard to this aspect of Enron's motion, the motion is denied.

5. To some extent Enron's motion for clarification appears to be simply a request that the PSC identify the "qualifications and conditions" to which the statement refers in paragraphs 64 and 92. As mentioned above, Enron indicates that it has searched for "qualifications and conditions," but has found none. In this regard the PSC can provide Enron with an assurance that it has not missed any substantial "qualifications or conditions." The PSC firmly determined that Order No. 5898d would include no direct and substantial revisions to the terms of Stipulation #3 (para. 64) or the GTC-1 Stipulation (para. 92).

III. REQUEST FOR RECONSIDERATION

A. Burden of Proof

6. In Order 5898d the PSC approved several stipulations directly related to the restructuring of MPC's gas utility. Restructuring opens the supply component of MPC's gas utility to competition (through a transition period), the supply component being moved from a regulated utility environment into an unregulated competitive environment. One of the PSC-approved stipulations, Stipulation #3, pertains in part to a restructuring issue commonly referred to as stranded costs. Stranded costs exist when, such as in the case of MPC's gas utility, a

regulated utility's investments which would have been recoverable through rates in a regulated environment are not recoverable in a competitive environment.

7. Enron is on record in this matter as an opponent of Stipulation #3, including as it pertains to stranded costs. On reconsideration Enron continues to object to the PSC's approval of that stipulation and believes that the PSC has failed to identify support of record for the establishment of stranded costs, the identification of the assets which form the basis of the stranded costs, and the value of those assets (amount of stranded costs). Enron therefore suggests that the PSC's order is unjust and arbitrary and constitutes a complete derogation of the PSC's duty as a regulator in consideration of the matter. In regard to stranded costs Enron also argues that the PSC has stated the law on burden of proof incorrectly, found the burden of proof unimportant, and failed to apply the burden of proof correctly. Also in regard to burden of proof Enron argues it is clear in law that the proponents of a stipulation must provide substantial evidence in support of their proposals. Enron also argues that one or more commissioners, through concurring opinions accompanying Order No. 5898d, incorrectly imply that the burden of proof has been shifted to the opponents of the stipulations.

8. The PSC determines that Enron's arguments are not persuasive. As stated at Order 5898d's paragraph 14, burden of proof remains an irrelevant concept (contrary to Enron's assessment burden of proof being "irrelevant" is not equivalent to "unimportant"). This is so because there is substantial evidence of record such that the PSC can lawfully approve Stipulation #3, including as it pertains to stranded costs. It does not matter who had the burden or whether MPC, other proponents to Stipulation #3, or opponents of Stipulation #3 submitted the substantial evidence. As the PSC has determined in Order No. 5898d and reaffirms here, there is substantial evidence of record such that its approval of Stipulation #3's stranded cost aspects is not arbitrary or without support or otherwise unlawful. Any commissioner implying through separate opinion that the burden of proof has shifted to the parties opposing Stipulation #3's stranded costs is correct. When there is substantial evidence of record supporting the position of a party or of several parties, then it is up to opponents to submit evidence to the contrary.

B. Support for Stranded Cost Recovery

9. Enron argues that the stranded costs approved through Stipulation #3 are not "verifiable" within the meaning of that term in sec. 69-3-1401, MCA. Enron's rationale is that stranded costs are not "verifiable" because they are not supported by substantial evidence. The PSC disagrees. The stranded costs are verifiable, including through the substantial evidence of record. Furthermore, there is no substantial evidence of record showing otherwise.

10. Enron argues that no market valuation was done, no evidence of record on the market value of stranded costs exists, and there is therefore no substantial evidence to suggest what MPC's production assets are worth in the open market. In this regard Enron objects to the PSC's statement in Order No. 5898d, para. 47, that all parties have agreed that MPC's production assets are out of market. Enron argues that there is no basis for this PSC statement and assures the PSC that it (Enron) has not admitted that MPC's production assets are out of market. Although the PSC is aware that Enron has disputed the amount at which MPC's production assets are out of market, the PSC was not aware that Enron has disputed that MPC's production assets are out of market. The PSC statement referenced by Enron is hereby amended to exclude Enron.

C. Characterization of Stranded Costs

11. Enron asserts that it was given "short shrift" at Order 5898d, para. 56, because the Commission found the difference semantical between its determination of when costs become stranded and Enron's assertion that costs do not become stranded until the day that a customer may choose between suppliers. The Commission meant no harm to Enron's position. It merely suggested that its philosophical perspective and Enron's are different. The Commission explained at para. 56 that Stipulation #3's plan to provide choice, which includes pilot programs and a lower contract cost of gas, is a convincing commitment to choice. Because of this commitment, which results in choice for all customers during the "plan" period, various costs underlying the transition plan become stranded during the plan period. The stipulating parties could have agreed to leave these properties in rate base for a short period of time during the transition period at a cost of capital of 11 percent to 12 percent. Instead, they recommended transferring the properties to MPC's supply unit so that they could be refinanced at 8 percent. The material reduction of costs and rates from refinancing was an important consideration for the Commission when it approved Stipulation #3. Taken as a package, the commitment and plan to provide choice to all customers, the pilot programs, the lower contract price of gas between

MPC's services and supply units, the relatively short transition period, and the lower cost refinancing and rate reduction were convincing reasons favoring Stipulation #3.

12. Following Enron's concern about semantical differences, Enron asserts that the Commission is confused and has difficulty in grasping the basic tenets of ratemaking. Specifically, Enron states that the order ignores the tenet "codified in the administrative rules that expenses must be 'known with certainty and measurable with reasonable accuracy' for rate recovery." To explain the alleged Commission difficulty, Enron refers to para. 52 where the Commission discusses the ratemaking tenet of used and usefulness. Enron opines: "It is undeniable that MPC's production assets are still 'used and useful' under basic ratemaking principles, as evidenced by the fact those assets will continue to provide gas supply to MPC's customers. At the time that customers no longer have a need for the supply from these assets, or choose another source of supply, then the assets will become stranded, and no longer 'used and useful' if the assets are in fact overvalued or unrecoverable. However, until that time, the costs associated with those assets are not 'known and measurable'."

13. The Commission finds Enron's reasoning unpersuasive. Stipulation #3 provides that MPC's production assets will be transferred from MPC's regulated rate base to MPC's supply unit, at which point MPC may use or dispose of the properties in ways that are consistent with the stipulation. For example, MPC's supply unit may transport other gas to MPC's services division if it sells some or all of its production properties to third parties: "The Supply Division may sell any other production or purchase gas that it may presently own or hereafter acquire to any market." Stipulation #3, p. 7. Because of the transfer out of regulated rate base, the used and useful ratemaking principle will no longer apply to the production properties. However, it and the known and measurable principle are satisfied by approving the gas costs and competitive transition charges (CTC-GP and CTC-RA) in Stipulation #3 because they are measurable, known with certainty, and are used and useful in the context of the transition plan.

14. Finally, the Commission specifies in para. 52 that traditional ratemaking has been affected by SB396: "This proceeding is somewhat different from the traditional approach to ratemaking because of the legislative mandates of SB396. Essentially, the life cycle logic has been modified by society's determination that the benefits of moving as quickly as possible to robust competition outweigh the benefits of vertically integrated monopoly." In other words,

life cycle used and usefulness for a rate base property may be affected by a Commission order that allows stranded costs for ratemaking purposes.

D. Competition and Market Power

15. Enron asserts that the Commission erred by approving the anti-competitive elements within the stipulations, which unfairly and discriminatorily provide MPC with market power. First, Enron asserts the Commission fails to appreciate the extent of MPC's market power by overlooking the fact that the supply contract is for five years. Second, Enron asserts the Commission misperceives and fails to respond to Enron's concern with respect to functional separation. While both of these points are vague, the Commission's responses follow.

16. The Commission did not overlook the fact that Stipulation #3 features a five-year contract. Before providing specific findings on this part of Enron's motion, Enron is reminded that the outcome, whereby market prices exceed contract prices, is not inevitable. Not surprisingly Enron focused on just this outcome. Contract prices could, however, exceed market prices. Furthermore, just as there is symmetry in possible contract-market price outcomes market power is also a two-edged sword. One can question whether Enron might have relatively more market power if contract prices exceed market prices.

17. For other reasons Enron errors when it asserts the Commission overlooked the fact that Stipulation #3 features a five-year contract. First, while limited to a minuscule amount of MPC's residential and small commercial customer loads, for the next two years MPC's pilot program is the only means by which such customers have the remotest opportunity to experiment with choice. Second, the pilot program will not begin until the 1998/99 heating season. The earliest such customers can begin to have choice, outside of the pilot program opportunity, is the 1999/2000 heating season. Even this opportunity is contingent on the pilot program's success. Choice is simply not an option until at least 1999/2000 and possibly the 2000/01 heating season for most residential and small commercial loads. Therefore, for the next few years most residential and small commercial customers will not have much need to be concerned about contract-market price differentials. This result is not an accident, but rather a deliberate result of moving towards opening up opportunities for competition in a systematic manner.

18. The absence of an exhaustive opportunity for choice for residential and small commercial customers is one consequence of the transition to choice. Enron may want all

customers to have choice now. While such a position is laudable, it is shortsighted. Many good intentions fail for lack of adequate planning. While not perfect, the combined effort of these stipulations is to move systematically, not haphazardly, in the direction of allowing competitive market forces to work their magic. The Commission has carefully considered the transition embedded in these stipulations. The next increment allows choice to customers with loads exceeding 5,000 dkt/year. This is a reasonable move in the right direction. In turn, MPC and other market entities need time to acclimate to the changing environment.

19. While a comparison of contract and market prices is relatively immaterial during the first few years, largely due to the absence of choice, it may be material in the last year of the transition. In the fifth year of the transition the lower of $1.60 dkt or the market price will be the contract price. Therefore, four years from now, when all residential and small commercial customers may for the first time have the right to choose, there will be the potential for an MPC advantage. Until that time, the reverse is also likely. Based solely on a comparison of contract and market prices, which is Enron's focus, court is out on whether the advantage is MPC's or a shipper's like Enron. The Commission suggests that the MPC core aggregation plan's marketing aspects consider noting the limited duration of the fifth year's pricing provisions.

20. The image of failure portrayed by Enron is simply unbalanced. If Enron reads the final order carefully, it will find a deliberate commitment by the Commission to provide an opportunity to analyze the existence of competitive supply markets. That opportunity is another stage at which Enron, if genuinely concerned, can participate in the competitive market analysis and subsequent steps to allocate customers to MPC and competing marketers. The Commission invites Enron's participation as opportunities arise to evaluate MPC's core aggregation plan, the pilot program's success, and the final analysis of the competitiveness of the gas supply markets.

21. The Commission concludes that Enron's arguments appear designed to, in part, afford Enron a competitive advantage. This strategy is expected, as we are nowhere near the point of having competitive gas supply markets in Montana. Enron's arguments fail to recognize the opportunities it and others will have to analyze the results of MPC's core aggregation plan, pilot program, and then the existence of competition. Perhaps Enron should first focus on the opportunities at hand -- the greater than 5,000 dkt market. After the dust settles in this increment

of the transition it will be timely to further open MPC's gas production to competitive forces. In this instance chaos is a poor solution to uncertainty.

22. Enron's motion asserts the Commission misperceives and fails to respond to Enron's concern with respect to functional separation. On this point, the Commission is essentially limited to restating parts of its final order. The Commission doubts anything less than disapproval and modification of the stipulations would mollify Enron. The Commission finds that, on balance, approval of the stipulations serves the public interest better than rejection, with its concomitant delay of the move toward competitive gas supply markets in Montana.

E. Revision of Stipulations

23. Enron argues that stranded costs should not be imposed on customers who do not have choice in gas supply. Enron also argues that the stranded costs are not stranded, because the production assets will be used to supply these customers. Enron asks that the PSC revise Stipulation #3 to provide that the burden of stranded costs will accompany the benefits of restructuring. The PSC denies Enron's requests. The PSC will not modify the stipulations. The PSC's rationale for approving stranded costs at this time rather than at some future time has been explained in Order 5898d and at points in this Order on Reconsideration (above).

F. Rate Design

24. Enron argues that the Commission's rate design findings are not reconcilable. Enron asserts there is no citation in this docket's record on which to base an incremental cost analysis and there is no regulatory precedent for the PSC's finding that "[m]onopoly transmission, storage and distribution services should be soundly based in incremental costs." Order No. 5898d, para. 39. Enron adds that this finding is not reconcilable with other findings requiring MPC to file an allocated cost of service. While favoring a "full allocation of costs," Enron asks the Commission to explain precisely what services and facilities should be priced on the basis of incremental costs.

25. As for the Commission's choices it is unclear whether to interpret Enron's point as a motion, rhetoric, or, as Enron states, clarification. Therefore, the Commission shall make several points that attempt to clarify. The Commission's only caveat is that Enron's motion raises questions, for the first time, that really must await any future MPC revenue requirement

docket. This is because the Commission's final order links the requirement for MPC to perform an incremental cost of service analysis to that revenue requirement request.

26. Enron's point that there is no precedent or any regulation for the finding that monopoly transmission, storage and distribution services should be soundly based on incremental costs is confusing, if not ill founded. Although unclear, if by "there is no citation to the record, or any regulation or precedent for this finding" Enron means there is no economic basis or no rulemaking authority, then a clarifying correction is in order. Incremental costing has a solid theoretic basis. This order on Enron's motion is not the place to recite costing theories, however. Further, since 1983 the Commission has had rules in place requiring incremental (marginal) gas cost analyses (ARM 38.5.176).

27. If by "there is no citation to the record, or any regulation or precedent for this finding" Enron means to suggest incremental costing is not practiced in Montana, another clarifying correction is in order. Even the casual observer of this Commission's cost of service activities would find this point of Enron's curious. Since the early 1980s incremental costs have been used to allocate resources for Montana's regulated utilities. For nearly two decades incremental costing was more often the rule than the exception in Commission gas and electric allocated cost of service dockets. Because Enron did not participate in those proceedings the Commission understands Enron's confusion.

28. Aside from the Commission's general policies implementing incremental costing, when and where feasible, Enron errors in asserting there is "no citation to the record" on which the finding can be based. As quoted in the final order, MPC witness Falvey, in his May 1997 rebuttal testimony states "there is nothing wrong with lower rates for incremental use, so long as those rates cover full incremental costs".

29. Generally, however, this docket is not about allocated cost of service. Therefore, the Commission is not entirely surprised by some of Enron's other comments. The Commission looks forward to Enron's participation in an allocated cost of service docket. In such a docket Enron will have the chance to explain and apply its fully allocated cost theories. Incremental costing, however, remains a technique this Commission will consider in subsequent allocated cost of service dockets. No service or facility would necessarily be exempt from this or some

other costing concept. We may find an absence of good cost data, incremental or otherwise, in any subsequent MPC gas docket. However, that remains the topic for a subsequent docket.

G. Specific Findings on Essential Issues

30. As its final basis for reconsideration Enron argues that the PSC has failed to make specific findings on issues essential to the PSC's decision (i.e., Order 5898d). Enron identifies eight "issues" which it asserts are within this category. Although the PSC will discuss some of these, the PSC determines these Enron "issues" are not issues and certainly not issues to which findings and conclusions or answers are essential to the PSC's decision. For example, Enron identifies as an "issue" what appears to be merely a question of Enron's that remains answered -- if full unbundling is not required in order to establish stranded costs what level of unbundling is required? All that is essential to the PSC's decision in the present matter is that it determine whether MPC's level of unbundling, full or otherwise, meets the requirements of law. This the PSC has determined in Order 5898d. What the PSC might do with some other level of unbundling presented to it in another restructuring case is not essential to the present decision.

31. Enron's list of issues also involves consideration of the impact on small customers of the straight fixed variable (SFV) rates advocated by MPC. (Enron’s reference to SFV appears to mean FERC’s SFV method of cost allocation.) The PSC did not fail to address this point. In fact it addressed several times. SFV is not a cost concept contained in any approved stipulation. In this regard it is like incremental costing. The final order clearly summarizes the third stipulation’s allocated cost of service content: “[a] careful reading of Stipulation # 3 reveals that it does not endorse or approve any cost theory, method, or party’s view on cost of service.” Order 5898d, para. 39. If Enron reads this finding carefully, it would not be asking the PSC to address any prior endorsement or testimony by MPC outside of the third stipulation. Neither this docket’s costs nor prices are based on the SFV or any other costing method. The SFV costing concept may arise in a subsequent allocated cost of service docket.

32. Enron’s list of issues also includes several general terms and conditions (GTC) issues, including standards of conduct for MPC and its affiliate supplier. These have been addressed through the PSC's approval of the GTC-1 Stipulation. Enron is also reminded of the PSC's development of gas restructuring rules. The rulemaking will include standards of conduct to govern utilities in the restructured environment. To the extent Enron believes the rules should

be more stringent than those included in the GTC-1 Stipulation, it should become involved in that rulemaking process.

ORDER

IT IS HEREBY ORDERED that the Motion for Reconsideration and Clarification of Enron Capital and Trade Resources Corporation is DENIED.

Done and dated this 2nd day of December, 1997 by a vote of 3-2.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

_____
DAVE FISHER, Chairman

_____
NANCY MCCAFFREE, Vice-Chair
(voting to dissent)

_____
BOB ANDERSON, Commissioner

_____
DANNY OBERG, Commissioner

_____
BOB ROWE, Commissioner
(voting to dissent, dissent attached)

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

DISSENT OF COMMISSIONER ROWE
ORDER ON RECONSIDERATION, DOCKET NO. D96.2.22, ORDER NO. 5898e

I do not support the Commission's decision to deny the motion for reconsideration without further briefs. The Commission could have made a more informed decision had parties proponent and opponent been requested to brief the issues raised.

RESPECTFULLY SUBMITTED this 2nd day of December, 1997.

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BOB ROWE, Commissioner